Idaho Division of Human Resources, October 1, 2002

Change in Employee Compensation Report

Report to the Governor

State Employee Compensation

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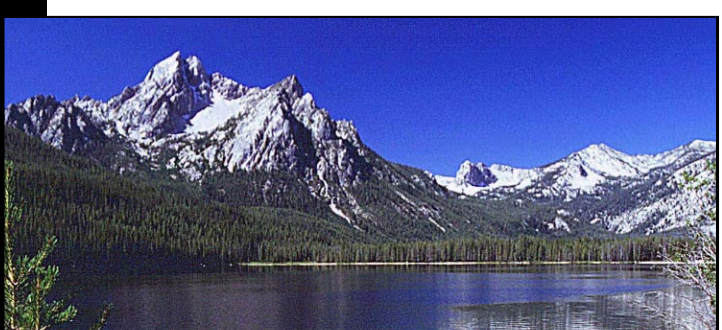
I. Executive Overview

This past year has brought financial difficulties to state governments across our country. Idaho state government was among the one in six employers nationally who froze salaries for all or some of their employees in 2002. Salary freezes or deferrals were common in the computer software and services and telecommunications industries, but rare in the more recession-proof areas of utilities, health care, and insurance. In general, employee wages have continued to grow, although at a slower pace than in previous years. As the economy begins to recover, most employers will address salary needs. Only one in 17 employers plan no pay raises in 2003. However, one HR management issue faces all employers - the skyrocketing cost of health insurance.

Our goal for FY2004 will be to find a balance between compensation and benefits in the face of significant health insurance cost increases and a possible hike in PERSI contribution rates.

National health care costs are increasing at extraordinary rates. Employee health insurance premiums are projected to increase an average of 17 percent nationwide. The cost of continuing a similar level of state employee health insurance coverage in FY2004 is forecasted to increase roughly $15 million. That cost is the same as a three percent Change in Employee Compensation (CEC).



The PERSI Board is considering a rate increase to stabilize the fund. Although a potential rate increase could be postponed for a year, even a relatively small increase would cost the state over $4 million, roughly the cost of a one percent CEC.

Projected increases in health insurance costs and potential PERSI contribution changes will impact both the employer and the employee. Given current revenues, it will be difficult for the state to cover its share of the health insurance cost increase. Any increase in PERSI contribution rates will be shared by both employer (63.5 percent) and employee (37.5 percent). Increases in health insurance costs and PERSI contribution rates could both have an impact on employee take-home pay.

Idaho Code 67-5309B(c) requires the Administrator of the Division of Human Resources to provide the Governor with an annual report by October 1 regarding state employee wages. As part of this report, the Administrator must:

- conduct or approve salary surveys;
- compare state wages to average labor market rates within the public and private sectors;
- report changes in the cost of living as measured by the CPI;

- report anticipated adjustments in the average weekly wage in the State of Idaho; and
- recommend changes in salaries, together with their estimated costs of implementation.

Idaho Code 67-5309C(b) states, "It is hereby declared to be the intent of the legislature that an employee may expect to advance in salary range to a market average rate for the pay grade assigned to the classification." Based on the salary survey results and prevailing wage analysis, state salaries are behind average labor market rates by approximately 11 percent.

Our employees are innovators who make state government more effective and efficient. Excellence, hard work and perseverance deserve to be rewarded. Our first recommendation is for a one percent personnel budget increase to allow for some permanent merit raises. In addition to that one percent, we recommend another one percent based on the state revenues exceeding a defined level. These increases will promote retention by providing a small pool of funds for agencies to reward and recognize high performing staff.

There are two critical areas where additional funding is recommended: nursing occupations and correction officers. These jobs within the state workforce have a large volume of employees, are the furthest behind market and have significantly high turnover.

One time payments or short term merit increases are also recommended. The use of this variable pay would allow agencies to retain and reward staff without increasing their fixed total payroll. Variable pay would be funded via agency savings or one-time appropriations and would be effective for the remainder of FY2003 and FY2004.

Summary of Recommendations for FY2004

- One percent merit increase
- Additional one percent allocation contingent on state revenue levels
- Additional four percent allocation for nursing occupations
- Additional two percent allocation for correction officers
- Allow agencies to utilize variable pay
- Fund part of the health insurance increase, but also consider coverage alternatives, increasing employee contributions and increasing prescription co-pays
- Change Idaho Code to allow multiple pay schedules which would represent market pay lines for different occupational groups
- Organize a team to study the statewide compensation system.

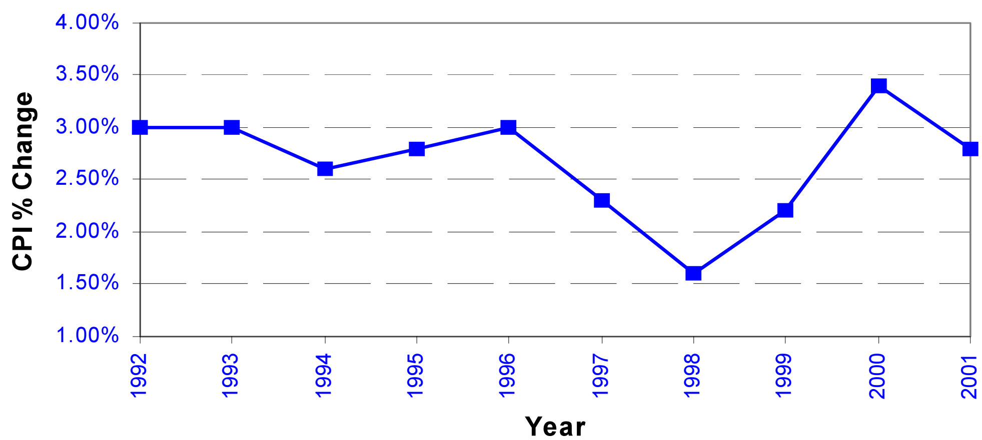
II. Economic Analysis

The state of the economy has an impact on the labor markets. Economic factors such as inflation and unemployment must be considered when performing job market and wage analysis.

Cost of Living

The change in the cost of living, as measured by the Consumer Price Index (CPI), increased by 2.8 percent in 2001. The CPI is published by the Bureau of Labor Statistics and measures changes in the cost of a fixed market basket of goods and services purchased by a hypothetical average family. Price increases are forecasted to hold around three percent annually.

CPI Percent Change 1992 - 2001



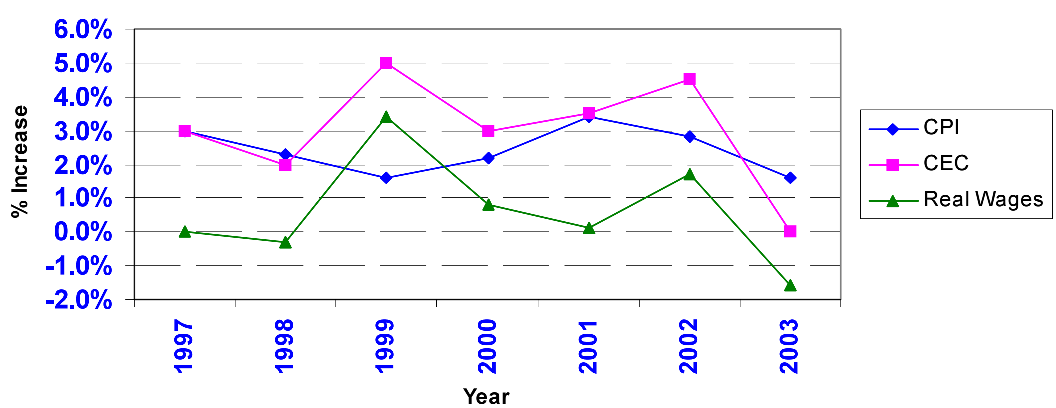
Real Wages

"Real wage increase" is a term used to describe a wage increase adjusted for inflation. It is calculated by subtracting the average annual price increase (in this case the CPI) from the actual wage increase. The difference is defined as the actual economic increase or "real wage increase." This is what is left for employees to improve their personal economic and financial lives. Real wage increases are calculated as follows:

Real Wage Increase = % Pay Increase - % Increase in CPI

Idaho State employees' real wages, as calculated using past CEC allocations, have increased 4.1 percent since FY1997, compared to 12.2 percent nationally (World at Work Annual Total Salary Increase Budget Survey).

Idaho Real Wages



Unemployment

Since May, the national unemployment figure has started to decline from its eight-year high of six percent. Economists believe the economy is at full employment when the unemployment rate is at five percent. The national unemployment rate is predicted to fall and return to its full-employment level by 2004.

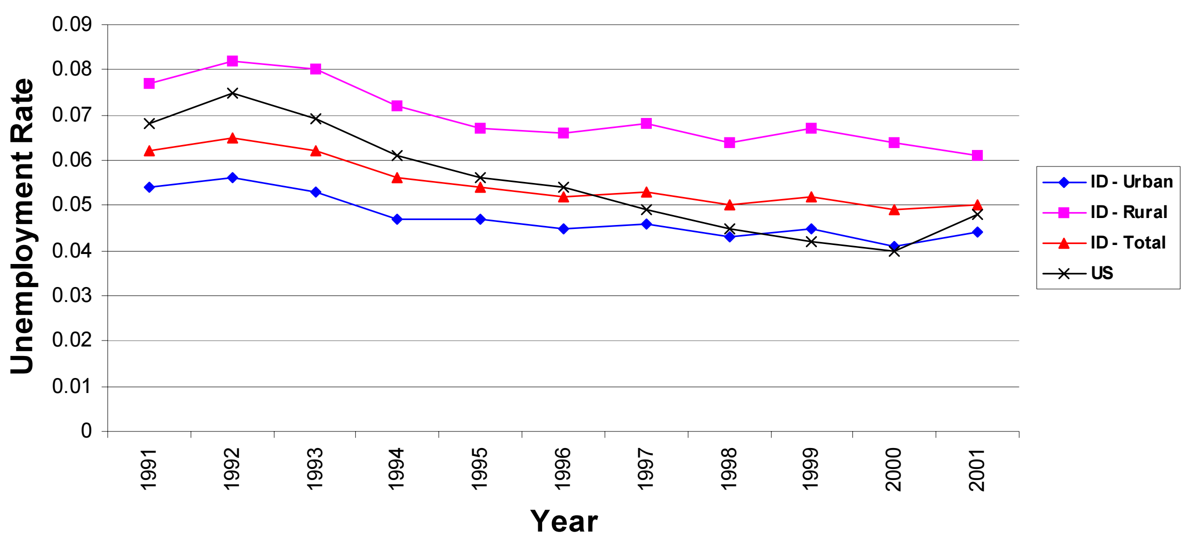
The national unemployment rate in July was 5.9 percent. Idaho's unemployment rate was 5.4 percent in July.

Over the last decade, Idaho rural counties consistently had unemployment rates higher than the state and nation. In 2001 the unemployment rate in Idaho's rural counties was 38.6 percent higher than Idaho's urban counties. Urban counties include Ada, Bannock, Bonneville, Canyon, Kootenai, Latah, Nez Perce and Twin Falls.

It may appear there is an excess supply of labor. However, currently 81 percent of state employees work in urban counties where unemployment rates are less than the full employment level. The primary labor markets in which the state competes are still tight.

Unemployment Rates

	Year										
	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
ID - Urban	5.4%	5.6%	5.3%	4.7%	4.7%	4.5%	4.6%	4.3%	4.5%	4.1%	4.4%
ID - Rural	7.7%	8.2%	8.0%	7.2%	6.7%	6.6%	6.8%	6.4%	6.7%	6.4%	6.1%
ID - Total	6.2%	6.5%	6.2%	5.6%	5.4%	5.2%	5.3%	5.0%	5.2%	4.9%	5.0%
US	6.8%	7.5%	6.9%	6.1%	5.6%	5.4%	4.9%	4.5%	4.2%	4.0%	4.8%



Increase in Average Weekly Wages

According to the Idaho Department of Labor, average weekly wages in Idaho increased by .2 percent in 2001. The increase in average weekly wages measures payroll growth in Idaho, *not employee pay increases*.

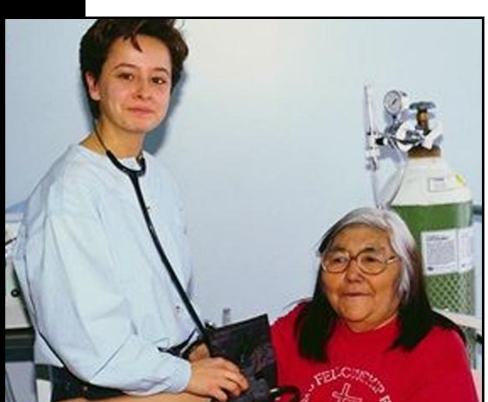
Idaho Average Weekly Wages

	1991	2000	2001
Total Covered	$379	$533	$534
Mining and Construction	$484	$572	$605
Manufacturing	$492	$841	$737
Transportation, Communications & Utilities	$474	$610	$641
Trade	$269	$382	$396
Finance, Insurance & Real Estate	$421	$642	$665
Services	$361	$484	$500
Government	$401	$540	$559

According to the Division of Financial Management, Idaho nominal income is projected to grow by 4.2 percent in 2002, 5.4 percent in 2003 and 5.9 percent in both 2004 and 2005.

The Job Market

There is a lot of interest in state employment. Much of this is attributed to relative job security, the ratio of benefits to wages in the lower skilled jobs, the accessibility of state employment opportunities and the ease of the application process provided by the new online application system. However, many job candidates do not meet minimum qualifications, as many state jobs require significant specialized expertise.



According to the Bureau of Labor Statistics, the market will demand over half a million new nurses between 2000 and 2010. Nurses have become some of the most sought-after employees on the market. Nursing salaries are forecasted to continue to grow at extraordinary rates over the next decade. Turnover within our nursing occupational group is 30 percent, compared to the statewide average of 12 percent. Private hospitals can afford to implement aggressive recruiting and compensation programs. Idaho's patient care programs depend on quality nurses.

In the late 90s the market for IT professionals was tight and salaries were very competitive. The passing of Y2K, declines in the "dot com" market and layoffs within the technology sector have all had heavy influences on the supply and demand for IT professionals. The state's turnover rate within IT occupations is below average; however salaries lag average market rates by 20 percent. We could be at risk of losing IT staff when the economy recovers and businesses increase their IT investment.

III. Pay for Performance

The most important component within a pay for performance system is consistent funding. Inconsistent or inadequate funding damages the system's credibility.

The Idaho Legislature redesigned the state compensation system in 1994. The plan called for employees to expect to advance in pay to a level equal to external market rates for their skills, ability and experience. Pay ranges were designed to be broad enough for managers to use discretion when hiring and rewarding staff. Across-the-board increases, cost of living adjustments and step or longevity pay were assumed to be included in a pay for performance methodology.

Pay Ranges

The state currently maintains a single pay schedule with 24 pay ranges for 1,200 different jobs. The range minimum is not necessarily the rate at which a new employee can be hired at. The policy point is assumed to be the market rate for jobs within a certain pay grade. However, this assumption does not always hold.

Compression

Salary compression occurs when the market wage is higher than that being paid to an organization's current employees, making it very difficult to hire new employees. It is the result of wages in the market growing faster than respective wages within an organization and is a significant problem for many state agencies.

There are three compression solutions and they are:

a) Hire an under-qualified employee at less than the market wage, resulting in the quality and quantity of work being compromised, or
b) Hire a qualified employee at the market wage rate. This damages the morale of the current employees by paying the new employee equal or more than the current employees, or
c) Increase the wages of the current employees to be competitive with the market and hire a qualified employee at the market wage. Of course, this is the most effective way to deal with compression and can be very expensive.

Compa-Ratio

The compa-ratio is an index which helps assess how organizations actually pay employees in relation to the pay grade policy point for a given job. It estimates how well actual practices correspond to intended policy. Calculated as the following ratio:

Compa-Ratio = average actual pay rate/pay range policy point

The state's compa-ratio is .91. The compa-ratio <u>does not</u> have relevance to an organization's market position unless policy points equal average market pay. Our policy points do not equal average market pay because the state assigns all jobs to one pay schedule. This dilutes the average market pay point within each pay grade.

IV. Compensation System Review

The Idaho State compensation system needs to be updated. The state's "one size fits all" system has not met the needs of such a diverse workforce with so many different occupational groups. The Hay Group recommends an audit of the compensation system every five years to ensure it is fair, efficient and meeting the goals of the state. Different occupations require different types of reward, recruitment and retention tools.

Hay and Supply and Demand

The Hay point factor system evaluates jobs with respect to know-how, problem solving and accountability. The state's current compensation system does not address the impact supply and demand has on job market prices. Jobs with the same Hay points are not always compensably equal.

Consider the following example: both IT Programmer Analyst and Financial Specialist fall into pay grade J with 332 Hay points. On average, the state pays both jobs almost equally, however the market wage for the IT Programmer Analyst is 44.6 percent higher than the Financial Specialist.

Class Title	Hay Points	Pay Grade	ID Avg Pay	Mkt Avg Pay
IT Programmer Analyst	332	J	$38,244	$51,505
Financial Specialist	332	J	$37,359	$35,625

Occupational Groups

The Division of Human Resources has analyzed all state jobs and categorized them into 13 unique occupational groups. This will allow the state to recognize market wage differences by the type of work performed, resulting in future pay recommendations by occupational group. Pay recommendations will focus funds to jobs which need them the most, thus strengthening our overall competitive position. The occupational group definitions are included in the FY2004 CEC Supplement. The defined occupational groups are as follows:

Proposed Idaho Occupational Groups

OG	Occupation Group Descrip.	Number of Classifications	Number of Incumbents
A	Information Technology	54	547
B	Finance and Accounting	58	610
C	Science/Environmental	78	329
D	Health Care - Medical	6	14
E	Health Care - Services	78	1,374
E1	Nurses Sub Group	10	510
F	Professional Services	390	1,868
F1	Para-Professional Sub Group	100	1,043
F2	Management Sub Group	137	278
G	Protective Services	27	1,316
H	Labor Trades and Crafts	156	1,283
I	Administrative	53	2,714
J	Engineering	20	931
	Total	1,167	12,817

Multiple Pay Schedules

In a market pricing compensation system, the pay schedule equals the market pay-line. Policy rates should represent the average pay for a respective job in the labor market.

Creating and maintaining multiple pay schedules addresses market differences for jobs which carry similar Hay points but are in different occupational groups. This progressive step will integrate a traditional "point factor system," with a "market pricing system." The point factor system will maintain internal pay equity within occupational groups while multiple pay schedules will promote competitiveness with external pay markets. This is more consistent with legislative intent regarding market average wages within an assigned pay grade. Multiple pay schedules are also supported by Hay Group consultants.

Referring to the previous example, multiple pay schedules would allow the state to manage IT Programmer Analyst wages at a higher and more competitive policy point than the Financial Specialist.

Customized Compensation Programs

The state would benefit from customized compensation programs for different types of work. It would be difficult for any organization to manage such a diverse workforce with a single compensation program. Different types of jobs require different types of reward systems and attraction tools. One example would be a new approach to paying correction officers. These jobs are stressful and fairly routine. Turnover costs are high because of the required training. The state may be able to reduce turnover by implementing a performance-based step program which moves Correction Officers through the pay range faster, say at 6 month intervals, and predetermined levels for the first few years on the job.

These different compensation programs should all share one basic construct, "pay for performance." Outside of that, each program could look vastly different in terms of pay grade structure and timing of pay increases.

V. Benefits

Employee benefits are a major portion of the state's total compensation package. The state offers the following discretionary benefits:

- Medical, dental and vision insurance
- Defined benefit pension program
- Life and disability insurance
- Paid vacation
- Paid holidays
- Paid sick leave

As reported by the Bureau of Labor Statistics, nationally, benefit costs continue to grow faster than salaries.

In the past, the perceived value of the state's benefits package helped offset shortfalls in market competitive pay levels. However as more companies compete for the best and brightest employees, our benefits package is now considered average compared to those offered by other medium to large employers.

Health Insurance Premiums

The cost of employee health insurance is estimated to increase an average of 17 percent nationwide. Many organizations are being forced to control health insurance costs by considering creative coverage alternatives. Employers nationwide are taking steps to shift some or all or the cost increases to employees.

The Office of Insurance Management is projecting that employee health insurance premiums will increase 15 percent in FY2004, this after a 25 percent increase in FY2003. The state currently pays $95.3 million in employee health insurance premiums. Maintaining year-on-year health care plan parity would require additional funding of approximately $14.3 million.

PERSI

The stock market downturn, for a second year in a row, has cost the state pension fund approximately $433 million for Fiscal Year 2002. Idaho Code requires PERSI trustees to consider increasing employee and employer contribution rates to stabilize funding of the system. A contribution rate increase would decrease employee take-home pay and increase demands on state agency personnel budgets. The following table shows the approximate impact a rate change would have on total state contributions and the take-home-pay of an employee earning an annual salary of $34,075.

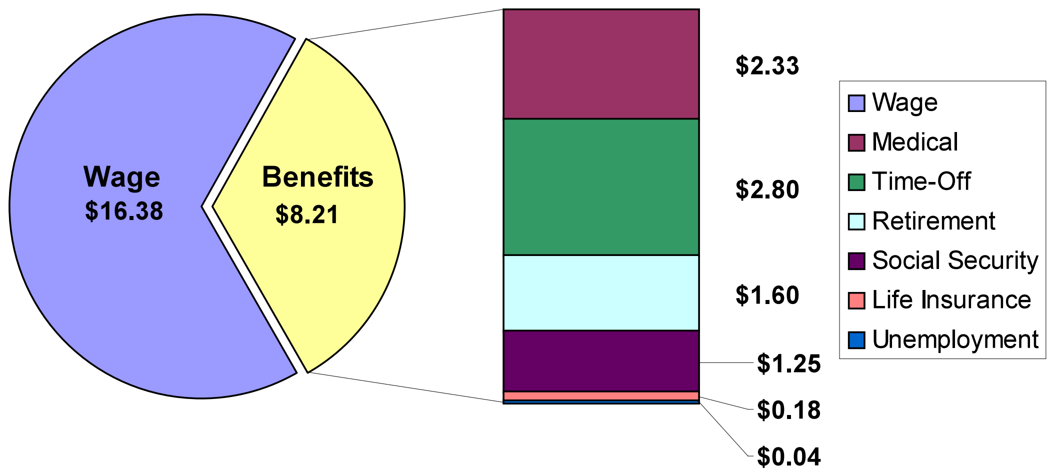
Overall Rate Increase	Monthly Decrease in Take-Home Pay	Annual Total Increase in State Contributions
1.2%	$10.67	$4,600,000
2.0%	$17.04	$7,700,000
3.0%	$25.45	$11,500,000

Total Compensation

The average classified employee makes a wage of approximately $16.38/hour and the State contributes another $8.13/hour in benefits. On average, 33 percent of a classified employee's total compensation package is made up of benefits.

Total Compensation Pie

Average State Employee

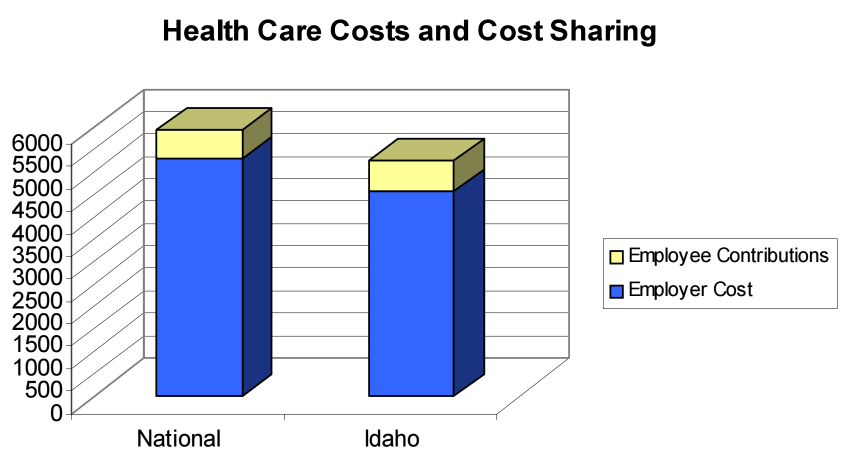


How Does The State Compare?

Simply comparing benefit costs does not tell the whole story given such factors as the age of the workforce, insurance claims, coverage options, differing time off accrual rates and the nuances of defined benefit pension program. However, benefit cost information is often the only data available to compare the State's benefits package to other employers.

The state pays $4,578 a year for health care coverage (not including dental and EAP). A state employee with a family on Blue Shield Module 2 contributes $673 a year. Based on a national study performed by Hewitt Associates, employers pay an average $5,314 a year and their employees pay an average of $626. State employees appear to have more out-of-pocket expense and the total value of the overall health care benefit is less than other employers.

	National	Idaho
Employer Cost	$5,314	$4,578
Employee Contributions	$626	$673
Total Health Plan Cost	$5,940	$5,251
Employer Subsidy Percent	89%	87%



VI. Salary Survey Findings

A salary survey provides wage data for a defined geography, industry, occupational group or level of job. Salary surveys must be reputable, scientific, unbiased and have job descriptions detailed enough to accurately match jobs. This year, DHR used the following four third-party salary surveys to establish labor market rates.

1. The **Idaho Cross Industry Salary and Benefits Survey**, prepared by Western Management Group, surveys 120 jobs with data compiled from 43 medium to large Idaho organizations. This is our most relevant survey because it studies our direct competition. This is probably the most widely used salary survey in the state. All companies in the survey also provide benefits to their employees. A list of survey participants is included in the FY2004 CEC Supplement.

2. The **Western States Salary Survey**, prepared by the Central States Compensation Association, surveys 214 state government jobs with data compiled from 10 states (ID, WA, OR, NV, UT, NM, AZ, CO, WY and MT). This survey only provides state government data.

3. The **Hay Group Salary Survey** provides national and regional data for more traditional "benchmark" jobs. This particular survey shows the largest pay disparities because of the private sector focus and most data comes from major metropolitan areas where the cost of living is much higher than Idaho.

4. The **Northwest Health Care Industry Salary Survey**, prepared by Milliman USA, surveys 237 jobs with data compiled from132 major northwest hospitals. This is a very focused survey which allows us to analyze pay for some of the hottest jobs in the nation.

Methodology

Benchmarks

Benchmark jobs are used as anchors for comparing our internal pay levels to the external labor market. Strong survey data must exist for a job to be considered a benchmark. DHR did not pre-select any benchmark jobs. State jobs are matched to jobs in the third-party surveys by reading job descriptions, evaluating work and making comparisons.

Benchmark jobs must <u>accurately represent</u> the organization's entire job population or statistical error can occur. This can result in recommending too much or too little for the entire employee base.

Relevant Labor Market Identification

Market analysis focuses on pay practices of public and private sector organizations within our own state, surrounding states and the nation. The state competes in different labor markets for different types of work. Most of the state's labor is hired from local markets; however, if a position is very specialized or high level, the state may compete in regional or national markets.

One of the most important components of an effective and efficient compensation system is definition of competitive labor markets. This effort allowed DHR to compare the appropriate survey data to the respective benchmark.

Analysis

The weighted averages (In this case, each salary is weighted according to the number of incumbents in a given job), as reported by respective salary surveys, are compared to wages of incumbents who hold benchmark positions. Our overall competitive position is calculated as follows:

Overall Competitive Market Position = (sum of actual incumbent salaries – sum of survey salaries)/sum of survey salaries

The most accurate method of performing market wage analysis is at the incumbent level to account for a job's relative weight. This prevents jobs with few incumbents from over-influencing the results.

The analysis covered 199 jobs and 8,118 (63% of the classified workforce) incumbents.

		Relevant Labor Market		
OG	Occupation Group Descrip.	Local	Regional	National
A	Information Technology	Most likely	Likely	Only if short supply or critical
B	Finance and Accounting	Most likely		
C	Science/Environmental		Most likely	Only if short supply or critical
D	Health Care - Medical		Likely	Most likely
E	Health Care - Services	Most likely		
E1	Nurses Sub Group	Likely	Most likely	
F	Professional Services		Most likely	Only if short supply or critical
F1	Para-Professional Sub Group	Most likely		
F2	Management Sub Group		Likely	Most likely
G	Protective Services	Most likely		
H	Labor Trades and Crafts	Most likely		
I	Administrative	Most likely		
J	Engineering	Likely	Most likely	

Market Pay Analysis Results

State employee wages currently lag average labor market rates by approximately 11 percent. Thirty-five (17.6 percent) of the 199 jobs studied are being paid at or above average labor market rates. The largest disparities are within the following occupational groups: I.T., nurses, management, protective services and engineering.

Weighted

OG	Occupation Group Descrip.	Idaho Salary	Survey Salary	% Difference	Turnover
A	Information Technology	$43,901	$54,870	-20.0%	8.0%
B	Finance and Accounting	$33,493	$34,979	-4.2%	11.0%
C	Science/Environmental	$38,951	$44,972	-13.4%	6.0%
D	Health Care - Medical[1]	**	**	**	7.0%
E	Health Care - Services	$36,731	$38,214	-3.9%	15.0%
E1	Nurses Sub Group	$34,528	$41,458	-16.7%	30.0%
F	Professional Services	$41,080	$46,153	-11.0%	9.0%
F1	Para-Professional Sub Group	$32,157	$34,702	-7.3%	10.0%
F2	Management Sub Group	$64,814	$77,724	-16.6%	12.0%
G	Protective Services	$32,112	$37,990	-15.5%	13.0%
H	Labor Trades and Crafts	$24,741	$27,867	-11.2%	13.0%
I	Administrative	$24,226	$25,616	-5.4%	15.0%
J	Engineering	$32,479	$40,622	-20.0%	5.0%
Statewide Weighted Average		*$31,311*	*$35,234*	*-11.1%*	*12.0%*

1. Physicians salaries vary widely and are not included in survey data.

World at Work Annual Total Salary Increase Budget Survey

World at Work (formerly American Compensation Association) conducts an annual salary increase survey. This year's survey includes 2,572 US organizations representing 12.9 million employees from a diverse cross-section of industries, including construction, manufacturing, transportation, publishing, information services, utilities, mining, health care, wholesale trade, retail trade and public administration. This is the most widely used report for tracking annual movements in salaries and salary structures.

Major Trends in 2002-03:

- US salary increases to average approximately 4.1 percent.
- 85 percent of US employees will receive a base salary increase, 10 percent lower than 2001-02.
- Despite stock market volatility, stock remains a strong component of variable pay.
- Granting large amounts of shares, however, appears to be losing favor.
- Variable pay decreased in 2002-03.
- 36 percent of organizations report difficulty with attraction and retention, compared to 71 percent in 2001-02.

A common misperception is employees are not rewarded during tough economic times. Depending on the size and length of a downturn, it may be natural to see salaries grow at a slower pace, but not stagnate or decrease. Results of the World at Work Annual Total Salary Increase Budget Survey show that many employers are investing in their workforce despite the recession.

VII. Recommendations

These recommendations reflect the professional opinion of the Division of Human Resources Administrator as required by Idaho Code 67-5309B(d). Recommendations are meant to promote the state's overall competitive position by making it possible for state agencies to attract and retain talented state employees. The recommendations encompass employee pay and benefits as part of a total compensation philosophy.

Merit Increase Recommendation:
In an "ideal" environment, recommendations would be robust enough to equalize state employee pay with external labor market rates. Given the state's current budget shortfalls, recommending no pay raises might be expected. However, two years without a pay increase impacts morale and retention. The state needs to do its best to keep high performing employees engaged in its mission even in tough economic times.

As pointed out previously in this report, a number of factors influence the need for additional funding for pay increases in FY2004.

Real Wage Analysis: state employee real wages have grown by 4.1 percent since FY1997 compared to 12.2 percent nationally.
Pay for Performance: Inadequate funding impacts the credibility of the pay program.
New Hire Compression: Wages in the market are growing faster than that of current state employees, creating unfavorable hiring circumstances.
Competitive Position: The state currently lags average labor market rates by approximately 11 percent.
Health Insurance Premium Increase: Health insurance costs are expected to go up by 15 percent in FY2004 and may impact employee take-home pay.
Potential PERSI Rate Increase: PERSI trustees may increase contribution rates in FY2004.
World at Work Annual Total Salary Increase Budget Survey: US salary increases to average 4.1 percent in 2002.

The base recommendation is a **one percent CEC allocation** of new funds over the current FTPs.

Additional recommendations include a **four percent CEC for nursing occupations and two percent CEC for correction officers** to deal with overly-competitive pressures within these occupations which experience higher than average turnover. These additional funds would be appropriated by agency by positions in the defined occupations. A list of nursing and correction officer occupations is contained in the FY2004 CEC Supplement.

An additional recommendation is to allocate another one percent merit pool to be awarded in August 2003, contingent on a pre-determined level of state revenues.

The approximate costs of these merit increase recommendations are:

	Percent Increase	Allocation Amount
General	1.0%	$4,700,000
Additional		
Nursing Occupations	4.0%	$833,958
Correction Officers	2.0%	$429,535
Total		***$5,963,493***

Health Insurance Recommendation:
As previously stated, the Office of Insurance Management is estimating a $14.3 million increase in annual insurance premiums.

We recommend the state fund part of this increase, but also consider plan design changes and the possibility of increasing employee contributions to mitigate the overall cost increase. The exact recommendation will depend on the amount we can save through a variety of plan adjustments. The value of the benefit levels must be carefully weighed against the impact to employees, as it was this year. A gradual shift to employee/consumer choices and responsibility for more costs of health care is our recommendation and is shared in businesses and government agencies across our country.

Over the past five years the state has subsidized a 61 percent growth in the cost of employee health insurance. Continuing to pour scarce resources into escalating health insurance costs without regard for employee salaries could result in a total compensation plan primarily driven by benefits. The challenge will be to find a way to balance the pay for performance philosophy with the benefits package.

Variable Pay Recommendation:
We recommend that agencies are directed to distribute any available funds to high performing employees in the form of variable pay (one-time bonuses or temporary merit increases). Variable pay would be awarded at agencies' discretion, up to two percent of their total personnel budgets. This recommendation should be in effect for the remainder of FY2003 and carry through 2004.

Variable pay is an effective and efficient approach. Employees are recognized with a monetary reward without increasing the organization's fixed total payroll.

Funding Source Recommendation:
Financing increases in personnel costs this year is, at best, challenging. DHR recommends a law change to allow managers to move funds into personnel from operating and capital outlay appropriations.

Fund shifts to personnel have been prohibited since the 1940's, more than likely to prevent abuse and misuse of program dollars. With advancements made since then in technology, accounting, controls, auditing, and personnel management, the law seems outdated. Contemporary management practices encourage employee participation in management decision making. Smart managers look for ways to operate their programs more effectively and efficiently, frequently resulting in reduced operating costs, either one-time or ongoing. The current law limits such savings, if spent, to be on operating or capital outlay, even when salary issues are higher priority. Appropriations could still be in categories, but during the fiscal year, managers should have the authority to move the money to where it is needed, as long as the appropriation bottom line remained the same. The cap of FTE also controls this spending and would safeguard uncontrolled growth in the workforce. This change would also provide additional motivation to managers and employees to work together to find ways to make government operations more efficient.

Recommendation to Review the State Compensation System:
We recommend replacing Idaho Code 67-5309(a) with language to allow for multiple pay schedules to be established via DHR rules. This would allow DHR to create pay schedules which represent market pay lines for the respective occupational groups.

We also recommend a team be organized to conduct a full review of our statewide compensation system. The team could consist of legislators, DHR staff, agency staff and representatives from the private sector.

The following items need to be reviewed and updated:

- The Hay system.
- Establishment of multiple pay schedules.
- Shift premiums.
- Idaho Code and DHR rules

VIII. Conclusion

Classified service still provides a level of job security rare in the job market today. The unique combination of meaningful work, job stability, health insurance and a defined benefit pension program helps attract and retain state employees despite the lack of market competitive wages. The increasing cost of employee benefits will continue to put pressure on employee take-home pay. Inconsistent funding for the pay for performance system presents serious competitive challenges.

During these tight economic times, state employees remain focused on their agencies' mission. They have earned and deserve an environment that supports them. For the short term, their future should hold:

- Occasional variable pay (short term merit increases and one time bonuses)
- Restructured pay schedules so salaries are tailored to meet the real market demand for their knowledge, skills and abilities
- Consumer-driven choices to help contain health care costs
- Updating the compensation system

State employees are resilient and dedicated. Many have weathered tough economic times before. In the next several months, every dollar of state revenue will have many competing and compelling priorities. All public employees, whether they are teachers, nurses or troopers, classified or not, deserve a market average compensation package. Recruitment, retention, and quality of public service are a worthy investment.